

November 17, 2004

Mary L. Cottrell, Secretary
Massachusetts Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, MA 02110

Re: D.T.E. 04-91, KeySpan/DOMAC

Dear Secretary Cottrell:

Pursuant to the procedural schedule adopted in this proceeding, the Attorney General submits this letter as his Initial Brief in D.T.E. 04-91.

I. Procedural History

On October 5, 2004, Boston Gas Company, d/b/a KeySpan Energy Delivery New England (“Boston Gas” or the “Company”) filed a Petition with the Department of Telecommunications and Energy (the “Department”) for approval of a Firm Vapor Service Agreement (“FVS”) with Distrigas of Massachusetts LLC (“DOMAC”) under the provisions of G.L. c. 164, § 94A. On November 10, 2004, the Department held a public hearing, immediately followed by an evidentiary hearing. The Company presented one witness in support of its proposal, Elizabeth Danehy Arangio, director of gas supply planning for KeySpan Energy Delivery.

II. The Company’s Proposal

The Company claims that its Everett propane facility is not capable of providing reliable peaking service without significant upgrades. Exh. EDA-1, p. 4. The DOMAC contract will allow the Company to retire the propane facility. Under the terms of the FVS agreement, the Company will purchase a maximum of three days peaking supply, 61,800 MMBtu of vaporized LNG, roughly equivalent to the propane facility output.¹ The FVS agreement is effective from

¹ The Company’s most recently approved Supply Plan had erroneously included the Everett facility’s “maximum output availability” at 40,000 MMBtus/day. According to the Company, “the Company adjusted its expected maximum output of the plant to 20,000 MMBtus/day going into the

November 1, 2004 through October 31, 2014. The Company negotiated a rate with DOMAC that includes a fixed annual call payment and a variable commodity charge. Exh. EDA-1, p. 4. According to the Company, the agreement “provides price protection for KeySpan such that the call payment may not exceed the call payment cap in DOMAC’s FERC-approved rate schedule FLSS, and the average commodity rate over the contract term is capped at the average of DOMAC’s FERC-approved rate schedule FVSS over the contract term.” *Id.*, p. 5.

The Company’s agreement with DOMAC represents an accommodation on the part of DOMAC and is part of a three way transaction among Prolerized New England Company (“Prolerized”), Boston Gas and DOMAC. *Id.*, p. 6. All three companies own adjoining property in Everett. DOMAC sought an easement from Prolerized, but Boston Gas owns a piece of the land to which DOMAC needed access. *Id.*, pp. 6-7. Prolerized and Boston Gas negotiated a twenty year lease, with an option to renew, for the propane facility site which is subject to (1) the approval by the Department of the decommissioning of the propane facility, including the removal of the propane tanks, and (2) approval of the FVS agreement with DOMAC for the propane replacement resource. *Id.* Under the terms of the lease agreement with Prolerized, Boston Gas will receive lease and property tax reimbursement payments. In a related transaction, Prolerized has entered into a licence agreement with DOMAC to use Prolerized’s parcel of land adjacent to DOMAC’s land. *Id.*

III. Ratemaking Treatment

The Company recovers approximately \$261,000 annually through its rates for the Everett propane facility²--\$245,000 through the CGA and approximately \$16,000 through base rates that are adjusted annually through the PBR mechanism in effect through 2013. Exh. AG-1-4. The cost recovery amount was set in the Company’s most recent base rate case. *See Boston Gas Company*, D.T.E. 03-40 (2003).

If the Department approves the Company’s proposal, the Company would continue to recover the \$261,000 cost of the propane facility from customers, as well as recover the full cost of the replacement resource, the DOMAC FVS costs, through the CGA.³ Exh. AG-1-9. The Company proposes to retain the benefit of the Prolerized lease payments and property tax

2003/04 peak season and determined that this output was both sufficient and necessary to reliably meet design day sendout requirements.” Exhibit EDA-1, p. 5.

² These costs represent capital recovery, return on the investment and operating costs. In addition to the \$261,000 production and storage cost, the Company recovers the commodity cost of the propane and inventory carrying charges through the CGA.

³ There are two components to the charges that the Company will pay to DOMAC under the FVS agreement, a fixed demand charge (an amount greater than the fixed production and storage related costs of the propane facility) and a commodity charge that is indexed to propane prices. Both charges will be recovered through the CGA.

reimbursements for its shareholders until the next base rate case which will not be effective until 2013, at the earliest.

IV. Standard of Review

In reviewing the propriety of a resource acquisition under the provisions of G.L. c. 164, § 94A, the Department determines whether the acquisition is consistent with the public interest. *Commonwealth Gas Company*, D.P.U. 94-174-A, p. 27 (1996), *Bay State Gas Company*, D.T.E. 98-79, p. 1 (1998), and *Berkshire Gas Company*, D.T.E. 04-35, pp. 7-8 (2004). The Department requires the petitioner to show that the acquisition is consistent with the company's portfolio objectives and that the acquisition compares favorably to a range of alternatives. *Id.* The Department examines relevant price and non-price attributes of each contract and considers whether the pricing terms are competitive. *Id.* The non-price attributes the Department considers are flexibility, reliability and diversity. *Id.* The Department also considers whether the company used a competitive solicitation process that was fair, open and transparent. *Id.* In approving Berkshire's supply agreement with Nexen, the Department found that the competitive solicitation process resulted in securing a least-cost replacement resource. D.T.E. 04-35, p. 11.

V. Argument

The Company did not issue an RFP for the proposed propane facility replacement resource and has not provided any evidence that the proposed substitution of the DOMAC peaking resource for the propane resource results in the least cost to customers, as required by the Department's standard.⁴ Rather, the Company provided a schedule of estimated costs that it would incur to upgrade the propane plant's reliability and continue the plant's operation. Exh. EDA-2. The Company compared those estimated costs to the fixed, call premium paid under the DOMAC agreement, the Prolerized lease and property tax reimbursement revenues. *Id.* The analysis shows that the DOMAC arrangement costs the Company more than the propane facility upgrade and the continued operation of the upgraded facility. *Id.* It is only due to the Prolerized payments that there is a benefit to the Company.⁵

⁴ As discussed below, the Company has stated that the DOMAC arrangement is "the result of a specific set of circumstances." Exh. EDA-1, p. 6.

⁵ On November 16, 2004, in response to a Department record request, the Company filed an analysis that was to "incorporate the actual benefits accrued to the firm sales customers." RR-DTE-1. The Attorney General has not had the opportunity to review the details of the analysis, but observes that the analysis, which claims to show a customer benefit, does not discount the purported benefits or demonstrate, on a present value basis, the amount of customer benefits. Because the "benefits" do not begin until the ninth year, customers are burdened with excess costs that are not off-set in later years' savings. RR-DTE-1. The Department relies upon present value analysis, which puts the time value of costs and benefits on an equal footing, to evaluate options affecting customers rates. *NSTAR Merger*, D.T.E. 99-19, p. 85 (1999), *Pilgrim Divestiture*, D.T.E. 98-119/126, p. 35 (1999), *Eastern Enterprises-Essex Gas Company Merger*, D.T.E. 98-27, p. 55. Using a consumer discount rate of 15%, the benefit

The Company's analysis does not reflect the costs to customers of the proposal. Customers will continue to pay more than \$261,000 annually for the decommissioned propane facility, and pay the monthly demand charges under the DOMAC agreement.⁶ This cost burden does not produce a least cost gas supply option. The Company has provided no analysis showing the customer costs and benefits associated with its proposal and no analysis of alternatives other than the Company's cash flow related to upgrading and maintaining the propane facility. Exh. EDA-2. Nor has the Company provided any cost estimates of what customers would pay if the LNG supply were unavailable due to security or other adverse conditions.

VI. Recommendation

Before approving the DOMAC contract and the decommissioning and removal of the propane facility, the Department should investigate all the related costs to customers. If the Department determines the DOMAC and Prolerized arrangements are in the consumers' best interests, the Department should allow the Company to recover through the CGA the same level of costs that would be collected under the propane facility operation. To allow the Company to recover both the current level of production and storage costs and the DOMAC demand costs would not result in just and reasonable, least cost rates. At a minimum, the Department should require the Company to credit the Prolerized revenues, lease payments and property tax reimbursements to the Company's CGA to mitigate the cost of the DOMAC demand charges. The Prolerized lease, because it is contingent on the Department's approval of the DOMAC agreement, is inextricably related to the supply contract⁷ and should be treated for ratemaking purposes as part of a gas supply package.

turns into a cost to consumers of between approximately \$1 million and \$200,000, depending on which level of propane facility upgrade is modeled. The Company has not provided any supporting documentation or witness testimony for the analysis, the feasibility of the facility upgrades, or related costs. The Department would have to conduct further investigation, discovery and hearings in order to rely on the record response in this proceeding.

⁶ The commodity cost of the DOMAC supply is based on a propane price index which, according to the Company, is comparable to the current propane commodity cost recovered through the CGA for the sendout from the Everett facility. Tr. 1, p. 21.

⁷ The Company acknowledges that no other supplier was considered and that "this contract was the result of a specific set of circumstances that motivated DOMAC to accommodate the Company's need for a propane replacement...[and] is the result of a three-way transaction between Boston Gas, DOMAC and Prolerized..." Exh. EDA-1, p. 6.

Sincerely,

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